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Federal Transfer Payment Update

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INTRODUCTION

Since last November's 2002-2003 Budget, federal transfers to Québec have been cut by close to \$2 billion for the period 2001-2002 to 2003-2004. This revision raises significant issues, mainly because of its nature.

Close to half of this revision results from a change to the calculation method of a single variable, the stock of residential capital, which the federal government uses to try to approximate the fiscal capacity of the provinces for the property tax base. Québec considers this change to be unacceptable for two reasons.

First, the rules of the equalization program stipulate that no change can be made during the five-year period that follows a renewal of the program. Accordingly, no change should become effective before April 1, 2004, the next renewal date.

Second, the changes in methodology the federal government is making will weaken the measurement of fiscal capacity for the property tax base, a tax base that already suffers from significant problems. This tax base relies on a complex formula based on a set of economic variables that, most often, have no direct relation to the property assessment rolls drawn up by municipalities. For over 15 years, Québec has maintained that municipal property assessment rolls are the true measure of the capacity to collect revenue from property taxes. Accordingly, equalization of property taxes should be based on these assessment rolls.

Furthermore, other substantial downward adjustments could be made to federal transfers beginning in 2002-2003. The announcement, last January 29, of an error in the calculation of personal income tax that Canada Customs and Revenue Agency (CCRA) collects for the other provinces could appreciably reduce Québec's equalization revenue. While it is currently difficult to estimate the financial impact with any precision because of the lack of complete information on the size of CCRA's error, it is generally admitted that it could be very large, perhaps as much as \$1 billion.

In this context, this paper:

- describes the major revisions to federal transfers since the forecast in the 2002-2003 Budget, mainly with respect to the property tax base for equalization;
- discusses the possible consequences of CCRA's error on Québec's equalization revenue;
- concludes with a review of recent developments in the equalization program and draws a number of consequences for the Québec government's financial framework.

1. REVISIONS TO FEDERAL TRANSFERS

Since the 2002-2003 Budget last November, the transfer revenue paid by the federal government to Québec has been revised downward significantly. For the period 2001-2002 to 2003-2004, federal transfers paid to Québec will be reduced by over \$1.8 billion, with changes to equalization accounting for virtually all of this reduction.

FEDERAL TRANSFERS - REVISIONS SINCE THE 2002-2003 BUDGET (Millions of dollars)

	2001-2002	2002-2003	2003-2004	Total
Equalization				
Change in methodology to property taxes	-470	-185	-185	-840
Other factors	-440	-422	-135	-997
	-910	-607	-320	-1837
Other revisions	67	17	-96	-12
Sub-total	-843	-590	-416	-1849
Deferral of the impact of the change to the property tax base	470	185	-655	-
Averaging of the impact of revisions to the property tax base	-	-	524 ¹	524
- Net impact	470	185	-131	524
Total	-373	-405	-547	-1325

¹ Amount saved in the short term that will result in an annual revenue shortfall of \$131 million for each of the following four years.

The nature of the revisions to equalization raises major issues. Close to half of these revisions is attributable to Statistics Canada's decision to change the method of calculating one of the variables, the stock of residential capital, which the federal government uses to try to approximate the property tax base for equalization. This change in methodology reduces the funds payable to Québec by \$470 million in 2001-2002 and by \$185 million over each of the following years.

In response to the Québec government's representations, the federal Minister of Finance decided to defer the impact relative to 2001-2002 and 2002-2003 to 2003-2004 and average it over five years. The practical effect of this decision is to replace Québec's revenue shortfall of \$470 million in 2001-2002 and \$185 million in 2002-2003 with an equivalent revenue shortfall of \$131 million a year for five years, starting in 2003-2004.

For Québec, it is clear that the proposed deferral and averaging, while limiting the financial impact in the short term, only shift the revenue shortfall over time and do nothing to resolve the basic problems associated with the property tax base for equalization.

2. EQUALIZATION OF PROPERTY TAXES

Property taxes are the second-largest tax base for equalization. Despite its size, it raises some of the greatest conceptual problems. To properly appreciate these difficulties, a review of the basic principles of the equalization program and how it operates is worthwhile.

2.1 The equalization program

The equalization program is designed to reduce disparities in fiscal capacity among the provinces. To this end, the federal government pays the less-affluent provinces, in accordance with section 36(2) of the *Constitution Act, 1982*:

[...] equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

Under this constitutional commitment, the federal government, using its tax revenue, pays amounts of equalization to eight provinces (Ontario and Alberta are the exceptions) whose fiscal capacity is below that of the five provinces that make up the program's "standard". This standard in fact reflects the average fiscal capacity of five provinces, namely Québec, Ontario, Manitoba, Saskatchewan and British Columbia.

How the program works

The amounts paid under the equalization program are estimated on the basis of the principle of the representative tax system. Under this principle, the definition of each province's capacity to collect revenue for each source of revenue considered must be representative of the taxation practices in effect in the provinces, and cover all sources of revenue.

The calculation of the amounts paid to a province as equalization can be broken down into three stages:

- Stage one: measure the per capita fiscal capacity of the province and compare it with that of the five provinces that make up the program's standard. This comparison is made for 33 different revenue sources.

- **Stage two:** offset disparities in fiscal capacity. The equalization entitlements of the province for a tax base are obtained by multiplying the disparity calculated in stage one by the average tax rate for all provinces, then by the province's population. Entitlements are negative if a province has excess fiscal capacity for a source and are positive if the province shows a deficiency.
- **Stage three:** add up the province's equalization entitlements. The total of the equalization entitlements calculated for the 33 sources of revenue subject to equalization constitutes the equalization entitlements for the province. If this sum is less than zero, the province receives no equalization.

**Calculation of entitlements: typical formula for
one of the 33 tax bases**

$$\begin{array}{l}
 \text{Equalization} \\
 \text{entitlements} \\
 \text{for a source} \\
 \text{of revenue in} \\
 \text{a province}
 \end{array}
 =
 \left[
 \begin{array}{l}
 \text{Fiscal capacity of the} \\
 \text{five provinces that} \\
 \text{make up the} \\
 \text{program's standard} \\
 \text{(per capita)}
 \end{array}
 -
 \begin{array}{l}
 \text{Fiscal capacity of the} \\
 \text{province (per capita)}
 \end{array}
 \right]
 \times
 \begin{array}{l}
 \text{Average tax rate} \\
 \text{of the ten} \\
 \text{provinces}
 \end{array}
 \times
 \begin{array}{l}
 \text{Population} \\
 \text{of the} \\
 \text{province}
 \end{array}$$

The equalization program is reviewed by committees of federal and provincial officials. The results of these reviews can give rise to revisions to the program. However, these changes can only be introduced once every five years. The program as it now stands covers the period 1999 to 2004. Accordingly, no change in methodology can be made to the program during this period.

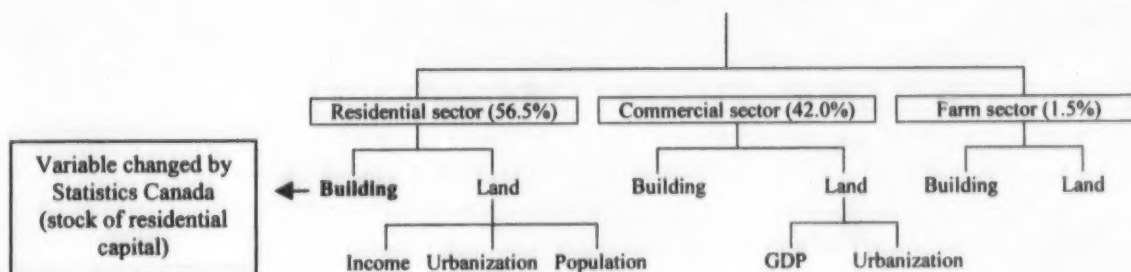
2.2 The property tax base

The changes made by Statistics Canada to the method of calculating the stock of residential capital help shed light on the major shortcomings of the current property tax base for equalization, in particular the fact that it is not defined according to the principle of the representative tax system.

2.2.1 Description of the existing tax base

Property taxes have been subject to equalization since 1982. As previously indicated, the current tax base is not based on property values as calculated by municipal assessment rolls but rather on a set of economic variables designed to produce an approximation of the value of land and buildings for the residential and commercial sectors. Only the farm sector, which however, accounts for a very small share of the property tax base, uses a measure of fiscal capacity based on property values.

Existing property tax base



For the residential and commercial sectors, complex mathematical relations are used to obtain an approximation of the fiscal capacity of the provinces. The formula used to estimate the residential tax base is given on page 10.

It is important to note that the change introduced by Statistics Canada, though it has a substantial impact on revenue for equalization, affects only one of the many variables used to estimate fiscal capacity for property taxes, i.e. the stock of residential capital.

FEDERAL ESTIMATE OF FISCAL CAPACITY FOR THE RESIDENTIAL PORTION OF THE PROPERTY TAX BASE

The equalization regulations define the residential tax base as follows:

$$\left[YPDA_i + \left(\frac{YPDA_{10} \cdot POPFUM_i}{POPFUM_{10}} \right) + \left(\frac{YPDA_{10} \cdot \Delta POP_i}{\Delta POP_{10}} \right) \right] \times \left\{ \frac{0.5216 \cdot K_{10}^R}{\sum_{j=1}^{10} \left[YPDA_j + \left(\frac{YPDA_{10} \cdot POPFUM_j}{POPFUM_{10}} \right) + \left(\frac{YPDA_{10} \cdot \Delta POP_j}{\Delta POP_{10}} \right) \right]} \right\} + K_i^R$$

Change
introduced by
Statistics Canada

where:

YPDA_i is the value of personal disposable income for the calendar year ending during the preceding fiscal year, less provincial and local indirect taxes for such year, other than provincial and local property taxes, taxes on legal persons other than those on profits, fees paid by businesses for motor vehicle registration and licenses, various taxes on natural resources and provincial and local taxes on the sales price and value of real property at the time of transfer, in each province, determined by Statistics Canada for its provincial economic accounts;

POPFUM_i is the product of the province's population for the preceding fiscal year multiplied by the urbanization factor:

- 0.580172 for Newfoundland,
- 0.513686 for Prince Edward Island,
- 0.695930 for Nova Scotia,
- 0.508889 for New Brunswick,
- 1.101451 for Québec,
- 1.401872 for Ontario,
- 0.900259 for Manitoba,
- 0.614636 for Saskatchewan,
- 0.953147 for Alberta,
- 1.432534 for British Columbia;

$\left(\frac{YPDA_{10}}{POPFUM_{10}} \right)$ is the fraction in which the numerator is the sum, for the ten provinces, of the YPDA_i and the denominator is the sum, for the ten provinces, of the POPFUM_i;

ΔPOP_i is the change in the province's population, including the estimated number of non-permanent residents, for the preceding fiscal year, less the province's population, including the estimated number of non-permanent residents, for the fiscal year five years prior to such preceding fiscal year;

$\left(\frac{YPDA_{10}}{\Delta POP_{10}} \right)$ is the fraction in which the numerator is the sum, for the ten provinces, of the YPDA_i and the denominator is the sum, for the ten provinces, of the ΔPOP_i;

$$\sum_{j=1}^{10} \left[YPDA_j + \left(\frac{YPDA_{10} \cdot POPFUM_j}{POPFUM_{10}} \right) + \left(\frac{YPDA_{10} \cdot \Delta POP_j}{\Delta POP_{10}} \right) \right]$$

is the fraction in which the numerator is the product of 0.5216 multiplied by the sum of the K^R of the provinces, and the denominator is the sum, for the ten provinces, of terms whose components are defined above;

K_i^R is the value of the province's net stock of residential capital, measured in current dollars, at the end of the calendar year ending during the preceding fiscal year, such value being determined by Statistics Canada for its estimates regarding flows and stocks of fixed capital.

2.2.2 Problem with the current tax base

The definition of fiscal capacity for this tax base has always been a bone of contention between the provinces, Québec in particular, and the federal government.

Québec has always maintained that the correct way to measure the fiscal capacity of provinces for this source of revenue is to use property values as measured by municipal property assessment rolls.

Québec has condemned the property tax base ever since it was implemented in 1987

In letters to the federal Minister of Finance, Don Mazankowski, the Minister of Finance of Québec, Gérard D. Levesque, noted his concerns with respect to the property tax base.

In a letter dated December 5, 1991, he indicated:

Officials of the equalization subcommittee have made substantial progress within the last few months with a view to using, for equalization purposes, the property assessment in each province.

Unfortunately, this work was set aside a few weeks ago on the excuse that it would be impossible to achieve satisfactory results by the March 31, 1992 deadline. It appears that we will have to be content with a few technical adjustments to a tax base that is clearly inadequate. It is unacceptable that we should have to wait another five years for substantial progress to be made in the measurement of fiscal capacity in regard to the second-largest source of revenue subject to equalization. On the contrary, every effort should be made to find a fairer solution right away. [OUR TRANSLATION]

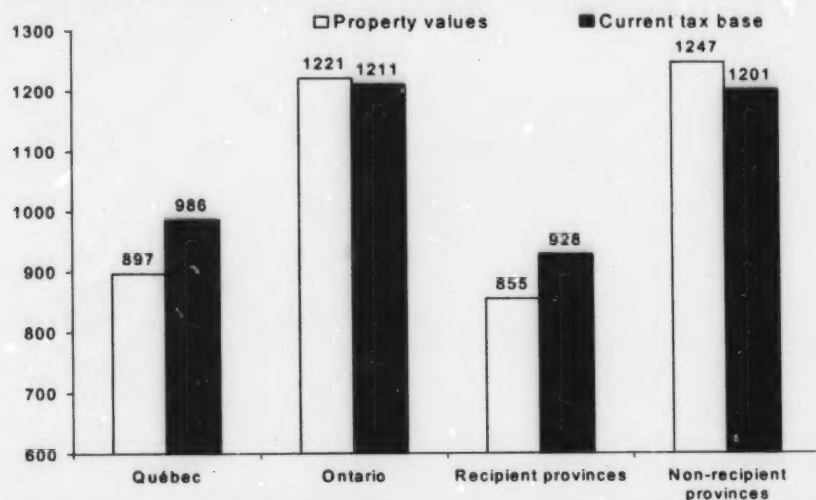
Another letter dated February 17, 1992 contained this passage:

Québec has often suggested during discussions on the renewal of equalization that the current methodology be replaced with a tax base using property assessment. This approach has the advantage of satisfying stated criteria for a tax base to be acceptable under the representative tax system, in particular since it reflects the taxation practices of governments. [OUR TRANSLATION]

Using the property values contained in municipal assessment rolls would have many advantages:

- It is compatible with the principle of the representative tax system, which is the very foundation of equalization, since these property assessments are used by municipalities to set property tax accounts.
- This approach is definitely simpler than the one used by the federal government.
- The data needed for this approach exist and are available from the provinces.
- In short, it would provide an acceptable measure of the fiscal capacity of provinces for property taxes, enabling equalization to do a better job of achieving its constitutional objective.

To date, the federal government has refused to use property values to measure the fiscal capacity of provinces for property taxes. The consequences of not using this approach are significant. For instance, using the data from Statistics Canada's 1996 census, Québec's fiscal capacity amounts to \$839 per capita rather than \$927 according to the federal approximation. The result is an overestimation of Québec's fiscal capacity of nearly 10%. The fiscal capacity of all the provinces receiving equalization is overestimated to a similar degree.

FISCAL CAPACITY FOR THE PROPERTY TAX BASE¹ - 1996
(Dollars per capita)

1 Obtained by correcting only the residential portion of the tax base using data on property values from the 1996 census.

Sources: Statistics Canada, Department of Finance Canada and ministère des Finances du Québec.

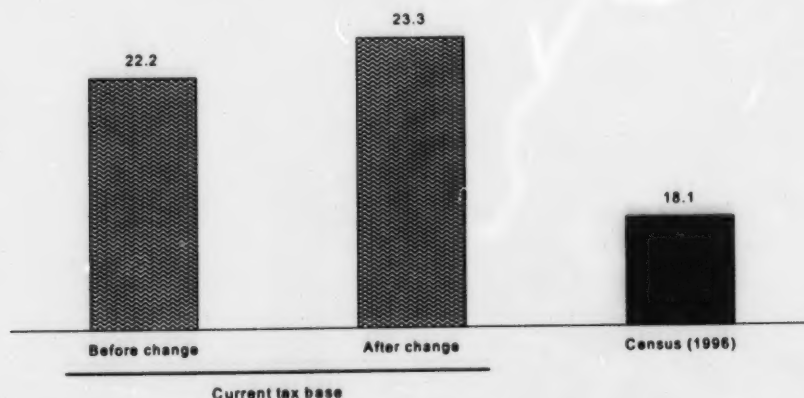
2.2.3 The change in methodology introduced by Statistics Canada exacerbates the problem

As has just been shown, the method used to estimate the property tax base is not representative of the fiscal capacity of the provinces to collect property taxes. Yet Statistics Canada's unexpected change to the method of calculating the stock of residential capital, introduced before the expiry of the current program, exacerbates the problem.

By changing its calculation method, Statistics Canada is increasing Québec's share of the stock of residential capital in Canada as a whole. For instance, for 1996, this share is raised to 24.9% compared with 23.2% before the change. Consequently, given the estimated value of land in the current tax base, this change increases Québec's share of the residential portion of the property tax base from 22.2% to 23.3%.

This change moves Québec further away from its true fiscal capacity for the property tax base since, according to the 1996 census, Québec's share of residential property value in Canada is only 18.1%.

**QUÉBEC'S SHARE OF THE RESIDENTIAL COMPONENT OF
THE PROPERTY TAX BASE**
(Per cent)



Sources: Statistics Canada, Department of Finance Canada and ministère des Finances du Québec.

The lower share according to the 1996 census data is notably attributable to the fact that:

- the value of homes is clearly lower in Québec than in Canada, the difference reaching at least 30% with regard to owner-occupied properties and at least 15% with regard to rental dwellings;
- Québec's percentage of rental dwellings (43.5%) is higher than Canada's (36.2%), and the unit value of rental dwellings (\$50 600) is only half that of an owner-occupied dwelling (\$103 179).

HOME VALUES
(1996 census)

	Québec	Canada	Difference
Average value of owner-occupied home	\$103 179	\$147 877	-30%
Average value of rental dwelling	\$50 600	\$59 500	-15%
Percentage of tenants	43.5%	36.2%	+20%

Sources: Statistics Canada and ministère des Finances du Québec.

The information provided by the census is corroborated by other indicators:

- According to Statistics Canada's Survey of Financial Security, in 1999, the average value of a principal residence was \$109 481 in Québec compared with \$149 661 in Canada.
- According to data of the Canadian Real Estate Association on the home resale market, in 2000, the average value of real estate transactions was \$111 260 in Québec compared with \$164 091 in Canada.

Furthermore, the value of rental units in Québec rises less rapidly than in Canada and the percentage of tenants has risen in Québec whereas it has fallen in Canada since 1996. These items further widen the difference in average value of housing units between Québec and Canada and, consequently, point to a deterioration in Québec's fiscal capacity for property taxes compared to the other provinces.

2.2.4 The problem needs to be corrected at its source

In response to the problem with the property tax base, the federal government decided to defer the impact arising from Statistics Canada's change to 2003-2004 and average it over a period of five years. For Québec, while this approach protects the financial framework in the short term, it only shifts the problem and does nothing to resolve the basic problem associated with the property tax base.

Accordingly, Québec advocates the following approach:

- cancel Statistics Canada's change in methodology in the calculation of equalization;
- adopt, at the next renewal of the equalization program in 2004, a measure of fiscal capacity for property taxes based on property values as measured by municipal assessment rolls.

3. THE ERROR MADE BY CANADA CUSTOMS AND REVENUE AGENCY

Last January 29, Canada Customs and Revenue Agency (CCRA) announced that, since 1972, it had made a significant error with regard to the personal income tax it collects for the provinces, with the exception of Québec. For the period 1993-1999 alone, CCRA indicated it had overpaid \$3.3 billion to four provinces, namely Ontario, Manitoba, British Columbia and Alberta.¹

Québec collects its own taxes and so is not directly affected by this error. However, it could be affected indirectly and suffer a significant reduction in its equalization revenue.

The federal government has yet to indicate whether or not it intends to recover the overpayments to the provinces. However, regardless of the federal decision, CCRA's error raises important issues regarding public finances and fairness among the provinces.

3.1 Nature of the error and direct impacts

CCRA's error is linked to the calculation of the capital gains tax of trusts that administer mutual funds.

From a tax standpoint, there is an advantage for holders of such mutual funds that the income be taxed in their own hands rather than in those of the trust. Accordingly, the legislation stipulates mechanisms for the income to be considered as having been realized by the holders. Furthermore, in some situations, the trust may receive a refund for the taxes they paid, to avoid double payment of the tax.

To do so, CCRA is responsible for paying the trusts before remitting to each provincial government, other than Québec, the amount of personal income tax due to it. Since 1972, the year capital gains became taxable, these remittances to some provinces have been too high because all the payments to the trusts have been made from the federal portion of personal income tax.

As the following table shows, for the period from 1993 to 1999, four provinces thus received excess revenue of \$3.3 billion. Although the information currently available is incomplete, the increase in capital gains in 2000 supports the assumption that the overpayments will be at least as large in 2000 as in 1999. Accordingly, the error for 2000 alone

¹ Nova Scotia and New Brunswick also received very small overpayments.

could add \$1.1 billion to the overpayments for the period 1993 to 1999. Restating this amount of close to \$4.5 billion on a per capita basis to facilitate comparison between the provinces, the overpayments amount to \$442 per capita in Manitoba and \$321 per capita in Ontario for the entire period 1993 to 2000.

OVERPAYMENTS TO THE PROVINCES BECAUSE OF CCRA'S ERROR
(Millions of dollars)

	1972 to 1992 ¹	1993 to 1999	Assumption 2000	TOTAL 1993-2000	
				\$ million	\$ per capita
Ontario	n.a.	2 803	1 000	3 803	321
Manitoba	n.a.	408	100	508	442
British Columbia	n.a.	121	40	161	39
Alberta	n.a.	4	1	5	2
Total	n.a.	3 336	1 141	4 477	222

¹ CCRA has yet to compile data for this period.

Sources: Canada Customs and Revenue Agency and ministère des Finances du Québec.

3.2 Possible impact on equalization

Although Québec is not directly affected by CCRA's error, its correction could lead to significant downward revisions to its equalization payments.

Recovery of the overpayments to the provinces would reduce the amount of personal income tax, which would lead to a downward revision of equalization payments for all the recipient provinces.

In addition, measurement of the fiscal capacity of the provinces could also be affected. If that is the case, the impact on equalization could be substantial. For the period 1993 to 1999, Québec would lose \$170 million in regard to revenue subject to equalization, plus a further \$452 million if the measurement of fiscal capacity is changed. The year 2000 alone could add losses of \$55 million in terms of revenue subject to equalization and of \$148 million in terms of tax base. The total impact for Québec for the period 1993 to 2000 could reach \$825 million.

In addition, in view of the additional impact of CCRA's error for the period 1972 to 1992, it is reasonable to believe that it could result in a total revenue shortfall for Québec of \$1 billion. Accordingly, the financial stakes are considerable.

POTENTIAL IMPACT ON QUÉBEC'S EQUALIZATION REVENUE OF THE RECOVERY OF OVERPAYMENTS TO CERTAIN PROVINCES BECAUSE OF CCRA'S ERROR

(Millions of dollars)

	1972 to 1992	1993 to 1999	Assumption 2000	TOTAL 1993-2000	
				\$ million	\$ per capita
Revenue subject to equalization	n.d.	-170	-55	-225	-30
Tax base	n.d.	-452	-148	-600	-81
Total	n.d.	-622	-203	-825¹	-111

¹ As previously indicated, this amount could reach \$1 billion once the impact from 1972 to 1992 is included.

Sources: Department of Finance Canada and ministère des Finances du Québec.

3.3 A fair solution for all

The financial impact arising from CCRA's error raises an important problem of fairness among the provinces.

The federal government, which has still not indicated what it intends to do in the wake of this error, has two choices:

- Number one, it could not demand reimbursement of the overpayments. However, this approach would be unfair to provinces that, like Québec, did not receive additional revenue and, what is more, had to deal with increased tax competition because of the greater capacity to reduce taxes the overpayments afforded the provinces that received them.
- Number two, the federal government could decide to recover the overpayments. However, that would result in a substantial revenue shortfall for all provinces that receive equalization, including Québec.

Québec considers that, in view of the federal government's large surplus, the fairest and least damaging solution, in financial terms, for the provinces would be that the federal government:

- complete the assessment of CCRA's error for the period 1972-1992 to obtain an overall picture of the size of the error and its impact on the provinces;
- not recover the overpayments to the provinces for personal income tax and equalization for the entire period;
- implement a compensation mechanism to afford fair treatment for all the provinces.

For purposes of illustration, the following table gives a sample compensation calculation on the basis of the information available for the period 1993 to 2000, which covers not only the overpayments made by CCRA but also their potential impact on equalization. During this period, Ontario benefited the most from CCRA's error, with an overpayment of \$321 per capita. The federal government could thus compensate all the provinces on this basis, taking into account the amounts paid under equalization.

On the basis of these preliminary estimates, Québec received \$111 per capita under equalization for the reasons mentioned above. To be treated fairly, that would mean payment of a federal compensation of \$210 per capita to bring it to a basis of \$321 per capita as in Ontario. For the period 1993-2000, such compensation would thus amount to \$1.6 billion for Québec and \$4.4 billion for the provinces as a whole.

Once the results for 1972 to 1992 are known, compensation for the entire period 1972 to 2000 should be reassessed on the basis of the indexed amounts.

ILLUSTRATIVE IMPACT OF A MECHANISM TO COMPENSATE PROVINCES FOR THE CCRA'S ERROR

	CCRA's error - 1993 to 2000		Total		Compensation ²	
	Overpayments \$ million	Potential recovery of equalization ¹ \$ million	\$ million	\$ per capita	\$ per capita	\$ million
Newfoundland	-	67	67	125	196	105
Prince Edward Island	-	16	16	119	202	28
Nova Scotia	-	108	108	114	207	195
New Brunswick	-	90	90	119	202	153
Québec	-	825 ³	825	111	210	1 552
Ontario	3 803	-	3 803	321	-	-
Manitoba	508	-164	344	299	22	25
Saskatchewan	-	121	121	119	202	206
Alberta	5	-	5	2	319	976
British Columbia	161	-	161	39	282	1 152
Total	4 477	1 063	5 540	179	142	4 392

1 Assuming that the federal government changes revenue subject to equalization and fiscal capacity. The exact size of these adjustments and their necessity remain to be established.

2 Calculated by granting all the provinces a per capita amount equal to that of Ontario, after deducting the amounts already received. For instance, Québec would receive \$210 per capita (\$321 - \$111 = \$210).

3 As previously indicated, this amount could reach \$1 billion once the impact from 1972 to 1992 is included. In addition, the amounts would have to be indexed.

Sources: Department of Finance Canada and ministère des Finances du Québec.

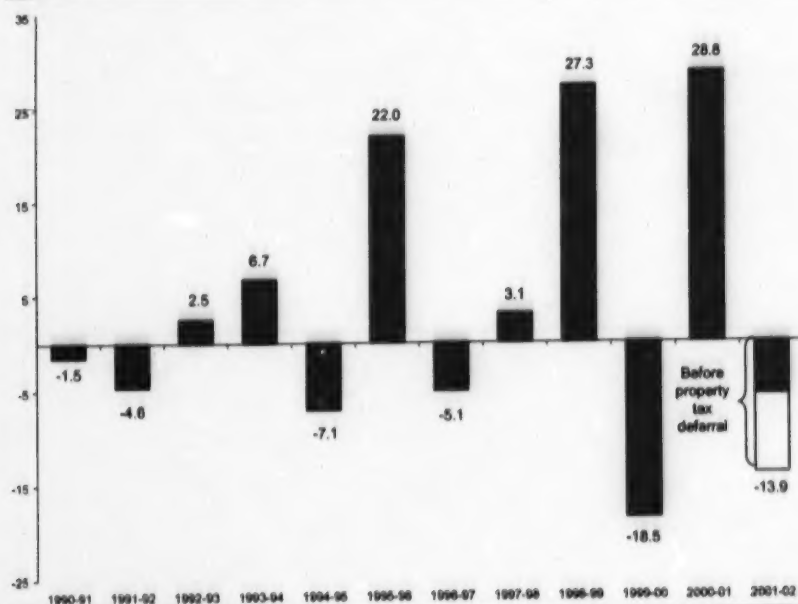
4. CONCLUSION

The preceding analysis has shed light on major shortcomings of the measurement of fiscal capacity for property taxes. It shows the urgent need to adopt, for the 2004 renewal of the equalization program, a measure of fiscal capacity for this tax base that relies on municipal property assessment rolls. This approach would be more compatible with the principle of the representative tax system on which the equalization program is based. In addition, the data needed for this approach are available from the provinces.

This analysis has also demonstrated the possibility of a substantial downward revision of equalization revenue that might arise from efforts to correct the error made by Canada Customs and Revenue Agency with respect to provincial personal income tax. In this regard, Québec has put forward a practical proposal to afford fair treatment for all the provinces. In view of the federal government's large financial surplus and so as not to destabilize the finances of the provinces, it would be preferable that the federal government pay compensation to the provinces that suffered rather than recover amounts from the provinces that received overpayments.

The revisions analyzed in this paper have a potentially significant financial impact that increases the uncertainty surrounding equalization payments that are already highly variable. For example, were it not for the federal Finance Minister's decision to defer the impact of the change in methodology to the property tax base to 2003-2004, equalization payments to Québec would have dropped by close to 14% in 2001-2002 compared to the preceding year.

**GROWTH IN EQUALIZATION PAYMENTS TO QUÉBEC -
1990-1991 TO 2001-2002
(Per cent)**



Source: Ministère des Finances du Québec.

The above chart illustrates the sizeable and repeated shocks affecting the equalization program. It sheds light on the substantial and erratic changes in amounts paid to the provinces under this program.

Such large variations in equalization payments have significant consequences. These variations usually occur with the federal estimates released at the end of February, a crucial time since it comes just a few weeks before the end of the fiscal year and the presentation of the budget in most provinces. Accordingly, the simultaneous achievement of the objectives of balancing the budget and effective planning of the delivery of public services can be compromised.